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No. 95-860

In The
Supreme Court of the United States
October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

On Writ Of Certiorari
To The California Supreme Court

BRIEF FOR PETITIONER

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QUESTIONS PRESENTED

1. Did Congress intend South Dakota's legislative definition of "interest" to define the federal term "interest" in Section 30 of the National Bank Act, 12 U.S.C. § 85 ("§ 85"), and thereby displace other states' contract laws limiting the form or the amount of liquidated damages for late payments on revolving credit accounts?

2. May Congress constitutionally delegate to South Dakota the power to define the federal lending term "interest" for all fifty states so as to preempt other states' contract laws?

3. As a matter of federal law, does the term "interest at the rate" in § 85 include contingent, sum-certain penalty charges (late fees), so as to preempt state limitations on the form or the amount of contractual liquidated damages on revolving credit accounts?

TABLE OF CONTENTS

TABLE OF CONTENTS – Continued

TABLE OF AUTHORITIES

Page

CASES

TABLE OF AUTHORITIES – Continued

Page

TABLE OF AUTHORITIES – Continued

Page

TABLE OF AUTHORITIES – Continued

Page

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

OPINIONS BELOW

The majority and dissenting opinions of the California Supreme Court (Pet. App. 1-72) are published at 11 Cal. 4th 138, 44 Cal. Rptr. 2d 441, 900 P.2d 690 (1995). The majority and dissenting opinions of the California Court of Appeal (Pet. App. 74-98) are published at 26 Cal. App. 4th 1767, 32 Cal. Rptr. 2d 562 (1994). The opinion of the California Superior Court (Pet. App. 99-105) is unreported.

JURISDICTION

The California Supreme Court entered judgment on September 1, 1995. On November 30, 1995, petitioner invoked this Court's jurisdiction under 28 U.S.C. § 1257(a) by filing a Petition for a Writ of Certiorari to the California Supreme Court. This Court granted review on January 19, 1996. 116 S. Ct. 806 (1996).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional and statutory provisions involved in this case are Article I, Section 1 of the United States Constitution (art. I, § 1); the Supremacy Clause (art. VI, cl.2); the Full Faith and Credit Clause (art. IV, § 1); Section 30 of the National Bank Act of 1864 ("§ 30"), Act of June 3, 1864, ch. 106, § 30, 13 Stat. 99, 108 (1864) (codified as amended at 12 U.S.C. §§ 85 & 86 (1994)); S.D. Codified Laws Ann. §§ 54-3-1.1 and 54-3-1 (1990); and Cal. Civ. Code § 1671 (West 1995). The relevant portions of these provisions are reproduced at Appendix A to this brief, Pet. Br. App. A.

STATEMENT

This case involves the question of whether "federalism counts"[1] for national banks under section 85 (§ 85) of the National Bank Act ("the NBA"). A divided California Supreme Court held that § 85 employs a federal "choice of law provision" that entrusts the lawfulness of a national bank's loan-related charges to the bank's "home state and to its home state alone." (Pet. App. 30). According to the court's reasoning, the law of a bank's home state, in this case South Dakota, in effect defines the words "interest" and "rate" in the federal statute and determines the scope of federal preemption under § 85. Because relatively recent South Dakota legislation has defined late fees and other charges as "interest," *see* S.D. Codified Laws Ann. § 54-3-1 (1990), that legislation, as incorporated into § 85 by the lower court's construction, preempts even nondiscriminatory contract laws of a borrower's state that limit default penalties such as credit card late fees, over credit limit fees, return check fees and attorneys' fees. Petitioner challenges this overbroad interpretation of § 85 because Congress did not intend to preempt the contract laws of a borrower's state limiting single-sum penalties.

A. Statutory Context

Congress passed the NBA in 1864 against the backdrop of the Civil War. A year earlier, Congress had enacted the NBA's predecessor, the National Currency Act of 1863,[2] which provided the model for the 1864 statute. As with most legislation, the two acts were products of legislative compromise, although both were intended to provide for a uniform

[1] *See* Kenneth Starr, Patrick E. Higginbotham, *et al.*, The Law of Preemption, A Report of the Appellate Judges Conference 40 (American Bar Ass'n pamphlet 1991) ("The Law of Preemption").

[2] National Currency Act, ch. 58, 12 Stat. 665 (1863).

national currency that would facilitate financing for the war.[3] While some of the NBA's sponsors wanted to abolish all state banks and establish a national ceiling on interest rates, Congress opted instead to promote and protect privately owned national banks in a way that respected fundamental principles of federalism.[4]

Sensitive to broad intrusions on traditional areas of state control, Congress designed the NBA to prevent discrimination without displacing all state tort and contract laws as applied to the federally chartered banks. In fact, the earlier Currency Act respected local control by authorizing national banks to charge "such rate of interest . . . as is . . . the established rate of interest for delay in the payment of money . . . by the laws of the several States in which the associations are respectively located, and no more. . . . " 12 Stat. 678-79. One year later, despite vigorous attempts to establish a national interest rate ceiling,[5] Congress continued to respect state interests by enacting § 30 of the NBA, now codified as § 85 and 12 U.S.C. § 86 ("§ 86"). As originally enacted, § 30 authorized the national banks to choose from three rates of interest: the general statutory rate allowed by the state where the bank was

[3] *See, e.g.*, John J. Knox, A History of Banking in the United States 97-99, 227, 233, 238-266 (1908); Bray Hammond, *The North's Empty Purse, 1861-1862*, 67 Am. Hist. Rev. 1, 8-10 (1961) (noting that the NBA "was of far less help to the war than the war was of help to it.").

[4] *See, e.g.*, Cong. Globe, 38th Cong., 1st Sess. 1889-1900, 1952-57 and 2142 (1864) (reprinting the debate over whether states would be allowed under NBA section 41, 13 Stat. 111-112, to impose nondiscriminatory taxes on the shares of national banks as personal property of each of a bank's shareholders, and rejecting amendments that would have limited such state taxation despite pleas for nationalism and attacks on so-called "states rights" positions).

[5] *See, e.g.*, Knox, *supra* note 3, at 233 (noting that the Comptroller of the Currency recommended in his 1864 report that "the penalty for usury should be forfeiture of the interest instead of a forfeiture of the debt, and this uniform rate of interest should be seven percent."); Cong. Globe, 38th Cong., 1st Sess. 2123-2127 (debating and rejecting uniform rate ceiling).

located, a higher statutory rate if such a higher rate was allowed for state banks, or, if the state did not have a statutory interest rate ceiling, then a federal interest rate of "seven per centum," 13 Stat. 108. As with the Currency Act, the goal was to respect local control of interest rate ceilings while preventing state discrimination against national banks in favor of state lenders with respect to the allowed rates.

To protect the national banks from potentially hostile state usury statutes and penalties, Congress also provided uniform federal usury remedies. If an excessive rate of interest was charged but not paid by the borrower, the bank would be liable for forfeiture of the interest only, not the interest and the debt, which was the penalty in some states. *See Farmers' & Mechanics' Nat'l Bank v. Dearing*, 91 U.S. 29, 32-33, 36-37 (1875). If the excessive rate of interest was already paid, the bank would be subject to the federal penalty of double the amount of interest it had collected. *See id.* at 32. So, for interest rates, Congress gave notice to the states that while they could still control rates evenhandedly for all banks located within their borders, the statutory penalties for usury would be preempted as applied to national banks. This political compromise did not, of course, provide any notice to the states that their state contract or tort laws affecting bank loans would be preempted.

Congress enacted these intricate provisions intending the term "interest" to have a federal definition that would not depend on unique state definitions. *See Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 410 (1874) (holding that "interest" in § 85 must "receive a strict, that is literal construction" to avoid subjecting the banks to the penalty of double the interest collected). Although the numerical *rate* of interest could vary from state to state, the meaning and substantive components of "interest" for national banks would be the same throughout the country. In other words, § 85 incorporates only the rate ceilings of a bank's home state, not the states' varying definitions of "interest" or the divergent statutory elements and penalties for "usury." *See National Bank v. Johnson*, 104 U.S. 271, 277 (1881) (explaining *Tiffany* and holding that only the "rate" of interest is federalized by § 85, not the character of the contracts banks are authorized to make).

Shortly after the NBA was passed, this Court recognized the Act's intricate design and addressed its preemptive scope. Although the newly chartered banks were federal instrumentalities, the Court emphasized that they were still subject to all state laws that did not directly conflict with federal law or "incapacitate[] the banks from discharging their duties to the government." *First Nat'l Bank v. Kentucky*, 76 U.S. (9 Wall.) 353, 362 (1870). In so holding, the Court observed that the banks "are governed in their daily course of business far more by the laws of the State than of the nation." *Id.* In addition, "their contracts are governed and construed by State laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts are all based on [and governed by] State law." *Id.* As a rule, the dealings and contracts of national banks are subject to general state laws except where there is an "express conflict" with federal laws, or the state laws frustrate the functions of the banks or impair "their efficiency to discharge the duties imposed upon them by the laws of the United States." *McClellan v. Chipman*, 164 U.S. 347, 357 (1896).

Congress's respect for federalist principles and local interests was tempered by its desire to ensure the success of the national banks. In *Tiffany*, this Court observed that § 85 bestows a most favored lender status on national banks. *See* 85 U.S. at 411-13. That status allows a national bank to charge the highest "rate" of "interest" allowed to any person (not just to state banks) by its home state. *Id.* at 413. In this way, national banks are "national favorites" because they enjoy greater interest rate authority than state banks in those states that limit the interest rates charged by state institutions. That most favored lender status is, of course, a product of § 85's language and design.

Years later, in *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978), the Court considered the meaning of the word "located" in § 85 and the preemptive scope of the section. Announcing what has become known as the "exportation" doctrine, the Court held that "located" has a firm, federal definition so that a national bank may "export" its home state's interest rate into other states. *See id.* at 310-14, 318. The Court ruled that a national bank located in Nebraska (the state identified in its federal charter) could charge the interest rate allowed by that state on loans to customers living in Minnesota, even though the Nebraska rate exceeded the statutory rate in Minnesota. *See id.* The Court did not, however, define the terms "interest" or "rate." Nor did it hold that the laws of a national bank's home state govern all the contractual terms or charges (other than "interest" as defined by Congress) imposed on consumers in other states.

Since *Marquette*, several small states (the "bank friendly states") and numerous banks have attempted to expand the "exportation" doctrine beyond the parameters established by this Court and Congress. During the 1980s, some of those states, most notably South Dakota, the current home of Citibank (South Dakota), N.A. ("Citibank" or "the bank"), and Delaware, sought to attract large credit card operations by deregulating banking and repealing consumer protection laws. *See* Federal Reserve Bank of Chicago, *Small States Teach a Big Banking Lesson*, Chicago Fed. Letter, No. 10 (June 1986). Recognizing that penalty fees represent a significant revenue opportunity that far exceeds any increased costs to issuers caused by late payments, the two states passed unique legislation that, contrary to the common law, redefined "interest" to include late fees, attorneys' fees and other contract terms and penalties. The idea was to allow national and other banks relocating to those states to "export" the terms and penalties into other states under the guise of "interest," a prospect that goes well beyond the holding in *Marquette* and the plain meaning of "interest at the rate" contained in § 85.

B. California Law

The California law involved in this case, Cal. Civ. Code § 1671, limits the charges all businesses, including banks, may impose on consumers for a breach of contract, such as a late payment. In contrast with the relatively recent legislation passed by bank friendly states like South Dakota and Delaware, California has followed the common law rule that compensatory "interest" is distinct from punitive contract penalties or forfeitures. For example, in *Beasley v. Wells Fargo Bank, N.A.*, 235 Cal. App. 3d 1383, 1 Cal. Rptr. 2d 446 (1991), *review denied*, 1992 Cal. LEXIS 1220 (Cal. Mar. 12, 1992), a case involving credit card late fees and overlimit fees, the California Court of Appeal recognized the ancient roots of this common law distinction. In describing the long-standing jurisdiction of equity courts over actions for relief from excessive liquidated damages, the court observed that "before 1697, the English courts of equity had exclusive jurisdiction to relieve a party from a penalty for breach of contract." *Id.* at 1391, 1 Cal. Rptr. 2d at 449, *citing* 2 Story, Commentaries on Equity Jurisprudence § 1301, at 536 (1836). The court further noted that under the Statute of William, passed by Parliament in 1697, a plaintiff in an action at law was limited to recovery of the actual damages for a breach of contract and could not recover any additional penalty provided for by the contract. *Id.* at 1392, 1 Cal. Rptr. 2d at 449.

This common law, the *Beasley* court found, was effectively codified in the 1872 predecessor to Cal. Civ. Code § 1671. Practically reflecting the current common and statutory law of liquidated damages, the 1872 legislation provided that a contractual predetermination of damages for breach of contract was void unless " 'it would be impracticable or extremely difficult to fix the actual damage.' " 235 Cal. App. 3d at 1398-99, 1 Cal. Rptr. 2d at 454 (quoting former § 1671). Thus, as the *Beasley* court held, current section 1671 "retains the former codified common law rule [of liquidated damages] for consumer actions." *Id.* at 1399, 1 Cal. Rptr. 2d at 454; *see Garrett v. Coast and Southern Fed. Sav. & Loan Ass'n*, 9 Cal.

3d 731, 739, 511 P.2d 1197, 1202 (1973) ("The fundamental difference between interest and penalty charges is that interest is a measure of compensation . . . while a penalty is punitive in character."). Important to the present case is the fact that this common law is separate and distinct from a statutory action for usury.

C. Factual Background

This case challenges the exportation of contract penalties as "interest" into states like California that limit or prohibit the contractual penalty provisions. From South Dakota, Citibank issues Visa cards and Mastercards to customers nationwide. (Pet. App. 110). Citibank charges these customers not only a hefty annual percentage rate but also a separate and additional $15 late charge if a specified minimum payment is not received within a number of days after the payment due date. In addition to Citibank's daily percentage rate finance charge, the bank charges the separate $15 late fee regardless of the outstanding balance, the amount of the payment owed, the actual number of days the payment is late, or the administrative costs associated with processing the late payments. (Pet. App. 114). Citibank's cardmember agreement treats the late payment as a technical breach of the contract and does not waive or forbear the default, even if the late fee is paid. (Pet. App. 117 & 122; *see* Jt. App. 49-82). Bearing no relationship to the amount owed, the passage of time or the bank's actual processing costs, and imposed in addition to continuing interest rate charges for delay, the late fee is a classic contract penalty. (Pet. App. 114-115).

Citibank charges its late fees in every state, including California, which indisputably regulates such charges as contractual liquidated damages or penalties, not as usurious interest. Here, Citibank exported its late fees into California and imposed them on Petitioner Barbara Smiley ("petitioner" or "cardholder") and other California residents. In response, petitioner filed this consumer class action on July 7, 1992, alleging that the late fees are excessive contract penalties

imposed in violation of California law. (Pet. App. 106-128). Since this litigation began, California has amended its laws to allow for the imposition of credit card late fees, but only in certain limited amounts. *See* Cal. Fin. Code § 4001 (West Supp. 1996). Under the lower court's holding, however, even those limitations also do not apply to out-of-state national banks because those banks are governed solely by the laws of their home states.

D. The Decision Below

Despite California's longstanding treatment of credit card late fees as common law contractual penalties, a 5-2 majority of the California Supreme Court upheld the dismissal of petitioner's complaint. According to the court, Congress has, in § 85, preempted all contract laws of a borrower's state that limit the loan-related fees of an out-of-state bank if the bank's home state has authorized the fees to be charged as "interest." (*See* Pet. App. 21-30). Since Citibank's late fees are considered "interest" under South Dakota's relatively recent legislation, the majority below concluded that California's liquidated damages law is preempted. (*Id.* at 39). In contrast, two dissenting justices reasoned that "interest" in the federal statute does not include the sum-certain contract penalties Citibank has exported into California. (*See id.* at 42 and 72). They would have ruled, as petitioner demonstrates below, that California's liquidated damages law is not preempted. (*See id.*).

SUMMARY OF ARGUMENT

This case will decide whether a bank's home state has boundless national lawmaking authority to preempt other states' contract, tort and consumer protection laws affecting credit cards held by consumers living in those other states. At stake is not only whether an out-of-state national bank can charge sum-certain late fees beyond the amounts allowed by the consumer's state, but also whether a consumer's state can

enforce other general contract, tort or consumer protection laws affecting bank loans issued by out-of-state banks. Eschewing a federal definition of "interest at the rate," the lower court construed the most favored lender principle of § 85 to encompass practically any loan-related term or charge. According to that court's reasoning, all laws of a borrower's state that have an indirect economic impact on the pricing of loans by national banks impermissibly intrude on the interest rates allowed by the bank's home state and must be preempted. Despite professing allegiance to this Court's precedents, both the lower court and respondent have disregarded the presumption against preemption and the "clear statement" rule. There is nothing in the text or the purposes of § 85 to support a finding that Congress enacted a boundless federal choice of law provision that empowers the home states of banks to establish lending laws for the entire nation.

The very context in which the NBA was passed establishes that Congress did not intend to enact a "federal choice of law" provision in § 85. Although the lower court emphasized the exigencies of the Civil War as proof of broad preemptive intent (*see* Pet. App. 24), the nature and causes of that vicious conflict actually prove the opposite. The Civil War Congress was acutely sensitive to broad intrusions on traditional state powers precisely because of that conflict. Given that sensitivity, Congress thoroughly debated and carefully crafted a banking act that generally respected state interests and displaced only those specific state laws that posed an actual threat to the success of the national banks. In other words, "federalism counts" in the NBA, as in all other statutes alleged to preempt state law.

To ensure that the political process has indeed considered the federal-state balance in making public policy decisions, this Court has employed a strong presumption against preemption. That presumption requires a "clear statement" of specific congressional intent before traditional state contract or tort laws are displaced. Neither indirect economic effects on, nor hypothetical interference with, the general subject

matter of a federal statute will suffice to preempt state law. If there is any doubt, state law must remain, for Congress retains the ultimate authority to broaden federal law and to make its intentions manifest.

The federal statute currently provides, in pertinent part:

> Any [national bank] may take, receive, reserve, and charge on any loan or discount made . . . , interest at the rate allowed by the laws of the State, . . . where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper . . . , whichever may be greater, and no more. . . .

12 U.S.C. § 85. Section 85 thus regulates the "rate" of "interest" that can be charged by national banks. Like the word "located" construed in *Marquette*, the phrase "interest at the rate" in § 85 must have a federal definition. If not, the statute would unconstitutionally delegate unlimited federal lawmaking authority to the home states of banks.

Here, the lower court reversed the presumption against preemption. The court stated: "Had Congress intended to limit preemption, it would have doubtless made itself plain. It did not. Its silence is especially deafening." (Pet. App. 24). This notion – that when Congress intends *not* to preempt, it must specifically state that intention – is contrary both to this Court's precedents and to the federalist design of the NBA itself.

Section 85 does not use the words "relating to," "loan related" or "all credit terms." While the availability of certain contract terms or default penalties may have an indirect economic impact on the market rate of interest a bank might charge on a loan, the terms or penalties are not themselves interest rates within the meaning of § 85. The plain meaning of "interest at the rate" has always denoted a compensatory charge measurable by time and based on the unpaid balance. The late fees challenged here are not compensatory charges because they are sum-certain penalties imposed in addition to continuing interest rate finance charges. The late fees are

designed to punish and deter a technical breach of the loan contract, not to compensate the lender for delay.

The common law also has consistently distinguished between compensatory interest in the nature of damages for delay and contractual penalties for unliquidated costs, such as dunning letters or collection activities. Although contractual penalties were not limited under the statutory rules of usury, they were regulated under the contractual doctrine of liquidated damages. In finding the late fees here to be "interest," the lower court confounded these two distinct concepts. Again, there is no evidence Congress intended or even considered § 85 to obliterate the common law of liquidated damages.

Contrary to the lower court's assumption, this case is not about the wisdom of late fees or any other service charge on bank loans. The case is about the authority of a borrower's state to enforce evenhanded contract and tort laws of general application against out-of-state national banks soliciting business from consumers in the state. Different states may make different policy choices. But those choices should be respected absent a clear federal policy to the contrary. Apart from interest rate ceilings (usury laws), Congress has not addressed the public policy choices imbedded in state limitations on late fees, attorneys' fees or other default charges. When a court or even a bank's home state makes that policy choice by redrafting the text of a federal statute, Congress's national lawmaking authority has been subverted and the presumption against preemption nullified. For these reasons, "interest at the rate" in § 85 cannot be construed broadly to invalidate California's longstanding contract, tort and consumer protection laws limiting late fees.

ARGUMENT

I. FEDERALISM COUNTS IN SECTION 85 OF THE NATIONAL BANK ACT

The presumption against preemption is not a mere doctrinal curiosity. It has a constitutional foundation and rests on

fundamental "[p]rinciples of federalism." *Department of Revenue v. ACF Indus., Inc.*, 114 S. Ct. 843, 850-51 (1994). The Court has recognized that "the principal means chosen by the Framers to ensure the role of the States in the federal system lies in the structure of the Federal Government itself." *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 550 (1985). The states *qua* states, and through their representatives in the central government, play a critical, if indirect, role in the crafting of federal legislation. James Madison explained that the federal government "will partake sufficiently of the spirit [of the States], to be disinclined to invade the rights of the individual States, or the prerogatives of their governments." The Federalist, No. 46 at 297 (James Madison) (Clinton Rossiter ed., 1961). Madison placed particular reliance on the equal representation of the states in the Senate, which he described as "at once a constitutional recognition of the portion of sovereignty remaining in the individual States, and an instrument for preserving that residuary sovereignty." The Federalist, No. 62 at 378 (James Madison) (Clinton Rossiter ed., 1961).

One of the vital "procedural safeguards inherent in the structure of the federal system," *Garcia*, 469 U.S. at 552, is the requirement of a crystal-clear statement of congressional intent before the states are stripped of the right to govern themselves and to protect their citizens against unfair, deceptive or unconscionable practices. *See California v. ARC America Corp.*, 490 U.S. 93, 101 (1989). Only a plain statement in the congressional legislation at the time the enactment is being debated can put the states on notice of the impending preemption of state law and enable the political safeguards of federalism to function. As the Court explained in *Gregory v. Ashcroft*, 501 U.S. 452 (1991), "inasmuch as this Court in *Garcia* has left primarily to the political process the protection of the States against intrusive exercises of Congress' Commerce Clause powers, we must be absolutely certain that Congress intended such an exercise. '[T]o give the state-

displacing weight of federal law to mere congressional *ambiguity* would evade the very procedure for lawmaking on which *Garcia* relied to protect states' interests.' " *Id.* at 464 (quoting LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW § 6-25 at 480 (2d ed. 1988)); *see* THE LAW OF PREEMPTION *supra* p. 2, note 1, at 47 ("When courts consider whether Congress intended to preempt state laws, . . . the nations' commitment to federalism would seem to argue for an *especially clear* statement of congressional intent to oust states from their traditional legislative functions." (Emphasis added)).

Here, the lower court disregarded these principles and developed its own reverse federal preemption doctrine. Instead of interpreting § 85 narrowly in light of the NBA's context, it construed the statute broadly to implement the court's own conception of the most favored lender principle. The court failed to recognize, however, that that principle is itself confined by the federal meaning of "interest at the rate" in § 85.

This Court has emphasized that " 'the historic police powers of the States [are] not to be superseded by . . . [a] Federal Act unless that [is] the *clear and manifest purpose* of Congress.' "[6] *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992) (plurality opinion) (emphasis added) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). As a result, a "narrow reading" of the federal statute alleged to preempt state law is required. *See Cipollone*, 505 U.S. at 518.

Contrary to the constitutional underpinnings of the presumption against preemption, the lower court treated these standards as if they applied only to the "*existence*" of preemption under § 85, not to the *scope* of that preemption. (*See* Pet. App. 12 & 14). This Court has made clear, however, that the

[6] Consumer protection is an historic and important component of state police powers. *See Griffith v. Connecticut*, 218 U.S. 563, 568-69 (1910); *see also Aldens, Inc. v. Packel*, 524 F.2d 38, 43, 48-49 (3d Cir. 1975), *cert. denied*, 425 U.S. 943 (1976).

presumption applies equally to the *scope* and to the *existence* of preemption. *See New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 115 S. Ct. 1671, 1676-77 (1995); *Cipollone*, 505 U.S. at 518. Indeed, "[a]ny indulgence in construction should be in favor of the States, because Congress can speak with drastic clarity whenever it chooses to assure full federal authority, completely displacing the States." *Bethlehem Steel Co. v. New York State Labor Relations Bd.*, 330 U.S. 767, 780 (1947) (Frankfurter, J., dissenting); *see Penn Dairies, Inc. v. Milk Control Comm'n*, 318 U.S. 261, 275 (1943) (Congress is always free to make its intention clear and to expand federal law).

Applying these principles, the Court has required the party asserting preemption, in this case Citibank, to establish to a "certainty" that federal legislation specifically preempts state law. *See Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 255 (1984). To meet that heavy burden, Citibank was required to prove either express or implied preemption. Express preemption occurs when Congress specifically states that it intends to preempt state law. Implied preemption arises: 1) where Congress has so comprehensively ruled that supplementary state legislation is inappropriate; or 2) where state law directly conflicts with federal law or "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *See English v. General Elec. Co.*, 496 U.S. 72, 78-79 (1990); *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). Here, § 85 does not preempt state regulation of sum-certain contract penalties either expressly or by implication.

Relying on the "*existence*" of preemption identified in *Marquette*, the lower court in effect construed § 85 as expressly preempting state laws relating to loan charges. (*See* Pet. App. 36). Apart from its dubious interpretation of *Marquette*, the lower court failed to realize that § 85 does not use the words "relating to" or "loan-related charges." It uses, instead, the simple phrase "interest at the rate." That precise

phrase – unadorned with any broader descriptions – demonstrates that the statute does not, expressly or by implication, preempt anything other than a compensatory charge calculable as a "rate" based on time and the balance owed. As this Court has noted, the enactment of a provision defining the preemptive reach of a statute provides a reasonable inference that matters beyond that reach are not preempted. *See Freightliner Corp. v. Myrick*, 115 S. Ct. 1483, 1488 (1995); *Cipollone*, 505 U.S. at 517.

Far from establishing broad preemptive intent, the absence of the terms "relating to," "loan-related charges," or "all credit terms" actually establishes that § 85 does not reach the late fees involved in this case. As this Court has recognized, Congress, not the judiciary, is charged with amending federal statutes to clearly state a broad preemptive intent. *See Gregory*, 501 U.S. at 462-64. The decision below has usurped that power from Congress and turned the presumption against preemption on its head.

Reading the decision below as implicating implied preemption does not correct these defects. Congress has *not* sought to preempt all state regulation of banking. To the contrary, this Court's precedents firmly establish the absence of a comprehensive federal scheme. *See First Nat'l Bank v. Kentucky*, 76 U.S. at 362; *McClellan v. Chipman*, 164 U.S. at 347, 356-57; *Anderson Nat'l Bank v. Luckett*, 321 U.S. 233, 248 (1944). Nor is there any direct conflict between the term "interest" in § 85 and California's law limiting sum-certain contractual penalties.[7]

California's regulation of penalty charges in no way prevents out-of-state banks from charging the unlimited interest rates that may be authorized by their home states, such as South Dakota. While the California liquidated damages law,

[7] To prove this type of implied conflict preemption, the bank must establish as a matter of fact an actual, not just a hypothetical, conflict between state and federal law. *See Rice v. Norman Williams Co.*, 458 U.S. 654, 659 (1982).

like its workers' compensation laws or even its zoning laws, may have an indirect economic bearing on the loan packages banks will offer in the state, it does not stand as an obstacle to the banks' doing business in the state or to the purposes of the NBA. *Cf. First Nat'l Bank v. Missouri*, 263 U.S. 640, 659 (1924) (state statute prohibiting branch banking does not frustrate or interfere with the purposes or the efficiency of national banks). In fact, banks located in California, though subject to the liquidated damages law, have not been impeded in performing their banking functions. *See, e.g., Beasley*, 235 Cal. App. 3d 1383, 1 Cal. Rptr. 2d 446.

Contrary to the presumption against preemption, and despite the absence of clear and manifest Congressional intent, the lower court, in effect, judicially redrafted § 85 to preempt more than its text directs. To be sure, § 85 is designed to prevent home-state discrimination against national banks with respect to interest rates. But that purpose does not convert the federal statute into a blanket override of sister state laws that might have an indirect economic impact on bank loan pricing or terms in those states. Indeed, in *Travelers*, 115 S. Ct. at 1671, this Court rejected such an indirect economic approach to preemption. Moreover, the NBA provides a substitute federal cause of action only for usurious rates of interest charged as consideration for a loan. *See* 12 U.S.C. § 86. It does not provide a claim for recovery of excessive contract penalties or a private right of action for challenges to unfair or deceptive banking practices. *Cf. Silkwood*, 464 U.S. at 255 (rejecting preemption of state law tort claims). Because the federal statute makes no mention of contract penalties, and because Congress has not even addressed the subject, § 85 does not preempt petitioner's California claims.

With the exception of state statutory or constitutional rate ceilings on "interest," as that term is defined by federal law, state law governs the contracts of national banks. *See First Nat'l Bank v. Kentucky*, 76 U.S. at 362. As long as the state law does not discriminate against the banks, it will apply. *See*

Anderson Nat'l Bank, 321 U.S. at 247-48 (NBA is intended to prevent discrimination against national banks, not to prohibit application of evenhanded state laws). In this case, California's law regulating both the forms and the amounts of contract penalties does not discriminate against national banks. It applies to all businesses equally.

Given the absence of a plain statement by Congress, Citibank cannot prove to a certainty, as it must, that the states and members of Congress were on notice that state contract laws limiting penalty charges or loan terms would be displaced by § 85 as laws either regulating interest or impacting economically upon interest rates. *See Gregory*, 501 U.S. at 464. Without a clear and definite statement of such broad preemptive purposes, the lower court could not have properly found preemption. As we detail below, there are no "clear statements" of such broad preemptive intent.

II. THE MEANING OF "INTEREST" IN § 85 SHOULD NOT BE DEFINED BY THE LAW OF THE BANK'S HOME STATE

A. The Most Favored Lender Principle Does Not Apply to the Package of Loan Terms

As a substitute for a clear statement, the lower court looked to the "most favored lender" principle. But that principle does not alter the plain meaning of "interest at the rate." Rather, the principle is itself confined by the plain meaning of § 85.

As noted, the legislative compromise that became § 85 respected federalist values while preventing discrimination against national banks. Congress's primary concern regarding interest rates was that a state might differentiate between lenders and set such a low rate that national banks could not profitably exist in that state. *See Tiffany*, 85 U.S. at 412-13. With the rejection of a uniform national rate, Congress decided to prevent discrimination by ensuring that national banks could charge the highest "*rate*" allowed in each home state. The "most favored lender" principle, announced in

Tiffany and discussed in *Marquette*, emanates from this design.

By focusing on the "rate of interest," not on the home-state's definition of the federal term "interest," the most favored lender principle allows a national bank to use its home state's *rate* to the extent that the *rate* conforms to the federal definition of "interest" in § 85. *See Evans v. National Bank*, 251 U.S. 108, 111 (1919) (NBA "adopts usury laws of the States only in so far as they severally fix the rate of interest"). Having its roots in the language of § 85 itself, the principle necessarily is limited by the federal meaning of the section. As explained in *National Bank v. Johnson*, the principle applies to the "rate of interest" alone and does not extend to all credit terms or credit charges:

> All that was said in that case [*Tiffany*] related to loans and to the rate of interest that was allowed thereon; and it was held that where by the laws of a State in which a national bank was located one rate of interest was lawful for natural persons and a different one to State banks, the national bank was authorized to charge on its loans the higher of the two. The sole particular in which national banks are placed on an equality with natural persons is as to the *rate* of interest, and not as to the character of contracts they are authorized to make; and that rate thus ascertained is made applicable both to loans and discounts, if there be any difference between them.

104 U.S. at 277 (emphasis in original). Accordingly, the most favored lender principle does not transform contingent charges for processing costs or deterrent penalties into "interest."

Contrary to these precedents, the lower court effectively construed the principle to embrace all loan-related fees. As recognized by the dissent below, however, a national bank's authority to impose single-sum penalty charges is not based

on § 85. (*See* Pet. App. 60-61 and 70-71).[8] Rather, section 24 of the NBA (formerly section 8, 13 Stat. 101) empowers banks "to make contracts" and exercise incidental banking powers. 12 U.S.C. § 24. Those incidental and contractual powers are governed by the basic tort, contract and other laws that are applicable to all lenders (indeed all businesses) conducting business *within a state*. Pursuant to these state laws, national banks can impose contractual terms to the same extent as other lenders (including natural persons) conducting business *in the state*. *See First Nat'l Bank v. National Exch. Bank*, 92 U.S. 122, 127 (1875) ("Banks may do, in this behalf, whatever natural persons could do under like circumstances."); *see also Perdue v. Crocker Nat'l Bank*, 38 Cal.3d 913, 938, 702 P.2d 503, 521 (1985) (12 U.S.C. § 24 does not preempt state law), *appeal dismissed*, 475 U.S. 1001 (1986). Of course, like other lenders, national banks are also bound by accepted conflicts of law principles and by the non-interest contract laws and public policies of other states. *Cf. First Nat'l Bank v. Kentucky*, 76 U.S. at 362 (banks are governed by general state law); *Arkansas Elec. Coop. Corp. v. Arkansas Public Serv. Comm'n*, 461 U.S. 375, 393-95 (1983) (each state may regulate areas of "legitimate local public interests" so long as burden on interstate commerce is evenhanded and not clearly excessive). Since these laws apply equally to all lenders, the NBA does not displace them or prevent their application to national banks. *See Davis v. Elmira Sav. Bank*, 161 U.S. 275, 290 (1896); *Anderson Nat'l Bank*, 321 U.S. at 247. In other words, only rates within the federal definition of

[8] *See also Anderson Nat'l Bank*, 321 U.S. at 248; *McClellan*, 164 U.S. at 357. The majority below ignored *Anderson* and declined to follow *McClellan* because "a century of law, however, has intervened." (Pet. App. 12, n.4). But *McClellan* and *Anderson* remain good law and were binding on the lower court irrespective of perceived changed circumstances or the passage of time. *See Thurston Motor Lines, Inc. v. Jordon K. Rand, Ltd.*, 460 U.S. 533, 535 (1983) (holding that lower court cannot disregard "old" Supreme Court precedent).

"interest" can be exported. For all other contractual terms, the states retain the power to enforce evenhanded restrictions that apply to both in-state and out-of-state lenders, including national banks.

The issue here is not whether Citibank can export "interest *rates*." Rather, the issue is whether it can also export contract penalties under the guise of "interest." The mere fact that a bank can impose certain contract terms and charges in its home state does not mean that all of those terms and charges are *federal* "interest." A contrary approach would have no logical stopping point, for South Dakota could define, as it has (*see* S.D. Codified Laws Ann. § 54-3-1, stating "including without limitation"), any loan-related term as "interest," and thereby preempt countless contract, tort and consumer credit laws of the other 49 states. *Cf. Healy v. Beer Institute*, 491 U.S. 324, 335-36 (1989) (extraterritorial application of state law causes "special concern . . . [as to] the autonomy of the individual States within their respective spheres.").

Relying on an expansive reading of the most favored lender principle, the court below concluded that "interest" must be interpreted broadly to achieve "uniformity and efficiency." (Pet. App. 29). But Congress rejected these goals when it refused to enact the national interest rate ceiling that the NBA's principal sponsors had advocated. *See* Cong. Globe, 38th Cong., 1st Sess. 1952-57, 2122-27. The lower court thus confused Congress's concern for discriminatory interest rate ceilings with a broader, unstated and unenacted intention to establish a federal choice of law provision. Nothing in the text or legislative history of the NBA either states or implies that Congress intended that broad preemptive purpose. Both the context in which the NBA was enacted and the status of national banks as federal instrumentalities indicate that if Congress had intended that purpose it would have said so specifically. Thus, the most favored lender principle is limited to the literal, federal meaning of "interest" and "rate."

That limitation makes sense here because Cal. Civ. Code § 1671 places absolutely no ceiling on the interest rates Citibank may charge pursuant to South Dakota law. The California law regulates only the form and procedure for setting contractual liquidated damages. Even if California law specified a maximum amount for sum-certain late fees, Citibank would still be allowed to charge the unlimited interest rate finance charges authorized by the South Dakota statute. As this Court recently noted in an analogous context, state law is not preempted merely because it might have an indirect economic impact on how a business may package its contractual charges or terms. *See Travelers*, 115 S. Ct. at 1677 ("If 'relate to' were taken to the furthest stretch of its indeterminacy, then for all practical purposes preemption would never run its course, for '[r]eally, universally, relations stop nowhere.' But that, of course, would be to read Congress's words of limitation as a mere sham, and to read the presumption against preemption out of the law whenever Congress speaks to the matter with generality." (Citation omitted)). Because California law does not regulate "interest," it does not conflict with § 85 or stand as an obstacle to the NBA.

B. A Limitless Home State or Administrative Definition Would Render § 85 Unconstitutional

When Congress enacts a statute, it ordinarily does not make application of the federal act dependent on state law. *Jerome v. United States*, 318 U.S. 101, 104 (1943). Moreover, when a federal statute is "[i]ntended to be nationwide in its application," its words should be given a federal meaning. *City of New York v. Feiring*, 313 U.S. 283, 285 (1941). These rules apply here and demonstrate that the term "interest at the rate" in § 85, like the word "located" construed in *Marquette*, has a federal meaning independent of unique state definitions.

In the § 85 case of *Haseltine v. Central Bank*, 183 U.S. 132 (1901), the Court concluded that "the definition of usury and the penalties affixed thereto must be determined by the National Banking Act, and not by the law of the State." *Id.* at

134. Similarly, in *Evans v. National Bank*, 251 U.S. 108, the Court recognized that both "interest" and "usury" were determined by reference to federal law, stating:

> The maximum interest rate allowed by the Georgia statute is eight per centum. That marks the limit which a national bank there located may charge upon discounts; but its right to retain so much arises from federal law. The latter also completely defines what constitutes the taking of usury by a national bank, *referring to the state law only to determine the maximum permitted rate*.

Id. at 114 (emphasis added). Similarly, in explaining *Tiffany*, the Court in *National Bank v. Johnson*, said that the most favored lender principle applies only "to the *rate* of interest, and not as to the character of [the bank's] contracts" 104 U.S. at 277 (emphasis in *Johnson*). So, contrary to the lower court's analysis, the definitions of a bank's home state are completely irrelevant to the meaning and the scope of the term "interest at the rate" in § 85.

If the rule were otherwise, "interest" and "rate" could have fifty different meanings provided by the fifty states. Each state could define "interest" however it wanted and could include attorneys' fees for collection, court costs, and countless other fees. This Court recognized the same danger in *First Nat'l Bank v. Dickinson*, 396 U.S. 122 (1969), where it considered whether federal or state law defined the term "branch" in the NBA. Permitting state legislatures to define the federal term "branch," the Court stressed, would "make them the sole judges of their own powers," and that "Congress did not intend such an improbable result." *Id.* at 133-34; *cf. Seattle Trust & Sav. Bank v. Bank of California, N.A.*, 492 F.2d 48, 50-52 (9th Cir.) (noting that Congress could not have intended only a bank's home state to regulate all the bank's contracts), *cert. denied*, 419 U.S. 844 (1974).[9] Here, too,

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[9] Courts, including the lower court, have misread other precedents such as *Citizens' Nat'l Bank v. Donnell*, 195 U.S. 369 (1904); *Daggs v.*

Congress did not intend for South Dakota to preempt the consumer protection laws and common law of California simply by revising the federal definition of "interest" to include penalty charges. *Cf. Mississippi Band of Choctaw Indians v. Holyfield*, 490 U.S. 30, 44 (1989) (there is no reason to believe that Congress intended to rely on state law for the definition of a critical term in the statute).

Despite these precedents, the lower court found that Congress "has . . . entrusted the question of the lawfulness of a national bank's late payment fees to its home state and to its home state alone." (Pet. App. 30). According to that court, Congress also has entrusted all "usury" issues and "credit terms" to the lender's home state. (*See id.*). Petitioner submits that "entrusting" one state to determine the scope of federal preemption amounts to an unconstitutional delegation of legislative authority to that state.

It is a familiar principle that statutes are interpreted to avoid constitutional difficulties. *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. and Constr. Trades Council*, 485 U.S. 568, 575 (1988). The lower court's construction of § 85, however, creates such difficulties because it causes the statute to be in violation of Article I, section 1 of the Constitution. That section provides that "[a]ll legislative Powers . . . *shall be vested in a Congress* of the United States." U.S. Const. Art I, § 1 (emphasis added). The lower court's interpretation of "interest" is actually a nondefinition that improperly vests

Phoenix Nat'l Bank, 177 U.S. 549 (1900); *Union Nat'l Bank v. Louisville N.A. & C. Ry. Co.*, 163 U.S. 325 (1896); and *First Nat'l Bank v. Nowlin*, 509 F.2d 872 (8th Cir. 1975), as authority for § 85 incorporating all state law defining interest and usury. Properly understood, those cases do not conflict with *Haseltine*, *Evans*, *Johnson* and *Dickinson*. Instead, they merely adopt a state "*rate*" (or numerical ceiling) of interest, not the state's definition of the components of interest. Also, unlike here, none of the charges involved in those cases was a sum-certain penalty charge for a contractual breach. Finally, the *Nowlin* court improperly disregarded this Court's controlling decision in *Evans*. *See Thurston Motor Lines*, 460 U.S. at 535 (lower court may not disregard controlling precedent).

unlimited legislative power in a bank's home state, not in Congress.

Contrary to the lower court's "entrustment" analysis, Congress has never incorporated state law without limit into a federal statute so as to boundlessly preempt other states' laws. Instead, Congress has limited incorporation to precise areas in which the state standard would operate principally within the boundaries of the state itself, not in other states. *See, e.g., United States v. Sharpnack*, 355 U.S. 286 (1958) (addressing Assimilative Crimes Act of 1948, which adopted state law as the federal criminal law for military bases and federal enclaves located in each particular state).[10]

Obviously, the case at bar is not one in which the incorporation of South Dakota law affects only South Dakota. Allowing state law to define and redefine "interest" in § 85 leads to the absurd and unconstitutional result that Congress has authorized South Dakota to legislate federal lending terms for the whole country. "To vest the power of determining the extraterritorial effect of a State's own laws and judgments in the State itself risks the very kind of parochial entrenchment on the interests of other States that it was the purpose of the Full Faith and Credit Clause and other provisions of Art. IV of the Constitution to prevent." *Thomas v. Washington Gas Light Co.*, 448 U.S. 261, 272 (1980).

In striking down a federal statute that effectively delegated interstate commerce powers to the individual states (and to the President), this Court has emphasized the necessity of federal guidelines limiting the delegated authority:

[10] The lower court, relying on *Sharpnack*, stated that Congress "has not made a delegation." (Pet. App. 30). If the § 85 term "interest at the rate" were narrowly and correctly defined by federal law, petitioner would agree. But the court made its definition dependent on state, not federal, law. The court thus apparently saw a distinction between "entrusting the question of the lawfulness of a lending charge" to a state and "delegating" the question of the lawfulness to a state. There is no such distinction in logic or in language, nor can there be.

> [The statute] does not seek to lay down rules for the guidance of state Legislatures or state officers. It leaves to the states and to their constituted authorities the determination of what production shall be permitted. It does not qualify the President's authority. . . . It establishes no criterion to govern the President's course. It does not require any finding by the President as a condition of his action.

Panama Refining Co. v. Ryan, 293 U.S 388, 415 (1935). Expanding on these principles, the Court has since identified three important functions of the nondelegation doctrine. One, the doctrine ensures that important choices of social policy are made by Congress, not by unrepresentative entities that are unresponsive to the popular will of the nation. *See Industrial Union Dep't v. American Petroleum Inst.*, 448 U.S. 607, 685 (1980) (Rehnquist, J., concurring); *see also Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 151-52 (1963) (construing a federal statute so as not to preempt a California law and thereby avoiding a difficult issue of whether Congress improperly delegated its authority). Two, it provides Congress's delegatee with an "intelligible principle" to guide the exercise of the delegated discretion. *Industrial Union*, 448 U.S. at 685-86. And, three, it "ensures that courts charged with reviewing the exercise of delegated legislative discretion will be able to test that exercise against ascertainable standards." *Id.* at 686.

Here, delegation to South Dakota of the legislative power to define, either directly or indirectly, the federal term "interest" fails on all three counts. The decision whether "interest" includes liquidated damages, attorneys' fees, court costs or other contractual penalties is "quintessentially one of legislative policy" that should be made by Congress, not by an individual state legislature that is unaccountable to the will of the nation. *See id.* Furthermore, neither the word "interest" nor the legislative history of the NBA provides any guidance as to the scope of the word or the limits of the delegated discretion. Indeed, as construed by the lower court, the most favored lender principle means that a bank's home state can

define anything to be "interest." Because, under the lower court's interpretation, Congress has provided no definition, established no standard, laid down no rule and declared no policy separate from that of the individual states, the delegation or "entrustment" inferred by the lower court is unconstitutional. *See Panama Refining*, 293 U.S. at 421, 430 ("The Congress manifestly is not permitted to abdicate, or to transfer to others, the essential legislative functions with which it is thus vested"); *Industrial Union*, 448 U.S. at 646 (plurality opinion) (construing statute so as to avoid open-ended delegation of legislative power).[11]

The Office of the Comptroller of the Currency's ("OCC") administrative definition of "interest," issued on the eve of argument in this case without an express Congressional delegation of preemptive authority, does not fare any better. In § 86, Congress expressly established the Judiciary, not the OCC, as the adjudicator of private rights of action arising under §§ 85 and 86. As the Court has held in similar circumstances, "a precondition to deference . . . is a congressional delegation of administrative authority." *Adams Fruit Co. v.*

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[11] Although *Marquette* has, in effect, permitted a bank's home state to establish "interest rates" that are controlling in other states, that result is not a forbidden abdication of Congress's lawmaking authority. Adoption of a state's time-based rate or required charge for a loan is in fact bounded and checked by a federal definition of "interest at the rate" that is limited to compensation for a loan of money for a stipulated time. *Cf. Bowsher v. Synar*, 478 U.S. 714, 732 (1986) (indicating that delegation of "essentially ministerial and mechanical" power is constitutional). That definition provides definite federal standards to determine whether a home state's "rate" comports with the will of Congress or exceeds Congress's intent. If, in contrast, South Dakota has been "entrusted" to expand the meaning of "interest" and "rate" so as to determine what credit terms are lawful, as the lower court held, then Congress has delegated to that state national lawmaking authority and Supremacy Clause powers. Allowing South Dakota to set not just a time-based rate required for a loan but also to define the actual rights and liabilities of credit cardholders (*e.g.*, what "late" means? whether attorneys' fees are collectible?), subverts the entire structure of federalism.

Barrett, 494 U.S. 638, 649 (1990). Here, as in *Adams Fruit*, Congress has not delegated to the bank's regulator any authority to expand, contract or define the scope of §§ 85 and 86. Because the statute provides both a uniform remedy and a private right of action, only the courts have that interpretive authority.

Moreover, even if the OCC was entitled to some deference because of its administration of the NBA, as this Court has instructed, far less deference is appropriate when the agency's interpretations have been inconsistent. *INS v. Cardoza-Fonseca*, 480 U.S. 421, 446 n.30 (1987). *Accord Sherman v. Citibank (South Dakota), N.A.*, 143 N.J. 35, 668 A.2d 1036, 1047 (1995), *petition for cert. pending*, No. 95-991 (U.S. filed Dec. 21, 1995). Here, the OCC has issued contradictory, unauthorized and eleventh hour definitions of "interest" that lack both a reasoned analysis and a rational explanation for its complete reversal in policy. Although the lower court presumably declined to defer to the OCC's interpretations because of the inconsistencies, it nonetheless noted its agreement with the agency's current policy. That agreement was equally incorrect.

In 1964, the Comptroller of the Currency issued an advisory bank letter that addressed the meaning of "interest" in § 85 and opined that "*[c]harges for late payments . . .* are illustrations of charges which are made by some banks which *would not properly be characterized as interest.*" OCC Letter, James Saxon, Comptroller of the Currency (June 25, 1964) (emphasis added). (Pet. Br. App. B, reprinting OCC letter). For the next twenty-four (24) years, the Comptroller's 1964 interpretation remained the view of the OCC regarding late fees. However, in 1988, the OCC staff took a different approach. In an informal opinion letter, the OCC's Deputy Chief Counsel concluded that "interest" in § 85 is defined by the law of a bank's home state, and if the state definition includes late fees or even attorneys' fees, then "interest" in § 85 will include late fees and attorneys' fees. *See* OCC Letter No. 452, R. Serino, Deputy Chief Counsel, *reprinted in* [1988-1989 Transfer Binder] FED. BANKING L. REP. (CCH) ¶ 85,676 at 78,064 (Aug. 11, 1988). Taking yet another

approach in 1995, the OCC Chief Counsel wrote that federal law, not state law, provides the definition of "interest" in § 85, and that under federal law, "interest" includes all expenses and charges related to a loan. *See* OCC Letter No. 676, J. Williams, Chief Counsel, *reprinted in* [1994-1995 Transfer Binder] FED. BANKING L. REP. (CCH) ¶ 83,618 (Feb. 17, 1995).[12] These conflicting analyses, among others,[13] demonstrate that the OCC's views have vacillated so dramatically and capriciously that they do not warrant any deference. *See Sherman*, 143 N.J. at ___, 668 A.2d at 1047. Thus, "interest at the rate" in § 85 must have a federal definition determined not

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[12] This letter violated the Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, § 114, 108 Stat. 2238, 2366 (codified at 12 U.S.C. § 43 (1994)). That statute, entitled "Notice Requirements For Banking Agency Decisions Preempting State Law," makes it clear that the OCC cannot issue an opinion concluding that state law is preempted unless it first follows certain stringent publication procedures. *See* 12 U.S.C. § 43. The OCC did not follow those procedures in issuing the Williams letter. *See* H.R. Conf. Rep. No. 651, 103d Cong., 2d Sess. 53 (1994), *reprinted in* 1994 U.S.C.C.A.N. 2039, 2068-74 (criticizing bank regulators for issuing overly aggressive interpretations preempting state law).

[13] In direct response to this and related litigation, the OCC, on March 3, 1995, issued a notice of a proposed interpretive rulemaking. *See* 60 Fed. Reg. 11924, 11929 (1995) (to be codified at 12 C.F.R. § 7.4001) (proposed Mar. 3, 1995). The notice proposed to interpret "interest" in § 85 over 100 years after the fact to include late fees and thereby preempt state laws limiting such penalties. On February 9, 1996, the OCC issued a "final" version of the proposed interpretation with an "effective date" of April 1, 1996. *See* 61 Fed. Reg. 4849-4870 (1996) (noting that the interpretation constitutes a "significant change" in OCC policy). Both the notice and the final version lack any reasoned explanation for the OCC's inconsistent and contradictory positions. The curious timing of the OCC's proposals, combined with the agency's inconsistent analyses, raises the specter of manipulation of pending litigation that this Court has decried as an "administrative shell game." *MCI Telecommunications Corp. v. AT&T*, 114 S. Ct. 2223, 2227 (1994).

by administrative fiat but by judicial canons of statutory construction.

III. AS A MATTER OF FEDERAL LAW, "INTEREST AT THE RATE" MUST RELATE TO THE TIME-VALUE OF MONEY

The lower court misapplied settled rules of statutory construction and confused two distinct concepts when it treated the late fees in this case as "interest." Interest may include three types of charges: (i) periodic percentage rates; (ii) definite up-front charges that can be amortized over a loan term for a per year rate (such as discounts or mortgage points); and (iii) interest in the nature of delay damages that are based on an unpaid balance and measured by time. The lower court equated the late fees here with interest in the nature of delay damages. But Citibank's late fees are not compensatory or based on time and the balance owed. The late fees are an entirely different type of charge.

The contingent sum-certain late fees are contract penalties, not interest in the nature of damages. As this Court has recognized in related contexts, the distinction between a "penalty as a fixed *ad valorem* amount taking no account of time, and interest which does depend on time, is persuasive." *Meilink v. Unemployment Reserves Comm'n*, 314 U.S. 564, 570 (1942). The difference is that "[a] penalty is a means of punishment; interest a means of compensation." *United States v. Childs*, 266 U.S. 304, 309 (1924). Longstanding common law has even treated excessive contract penalties as being against public policy and unenforceable. *See Tayloe v. Sandiford*, 20 U.S. 13, 18, 7 Wheat. 7, 9 (1822) (refusing to enforce contract penalties); *Kothe v. R.C. Taylor Trust*, 280 U.S. 224, 226 (1930) ("But agreements to pay fixed sums plainly without reasonable relation to any probable damage which may follow a breach will not be enforced"). So the question in this case is whether § 85 has so clearly obliterated the common law distinction between interest in the nature of

damages and sum-certain penalties that California's contract laws are preempted. The answer to that question is no.

A. The Plain Meaning of "Interest" Excludes Penalty Charges.

As the lower court recognized, § 85's impact on the common law of contract penalties depends on the breadth of the words "interest" and "rate" in the statute. But the statute does not define either "interest" or "rate." The starting point, then, is the plain meaning of the words. *See Park 'N Fly, Inc. v. Dollar Park & Fly, Inc.*, 469 U.S. 189, 194 (1985). This Court has stressed that the plain meaning of legislation should be conclusive, except in "rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters." *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 241 (1989) (observing that "interest" is distinct from "fees, costs, or charges"). Here, the literal definitions of "interest" and "rate" are consistent with Congress's intention in the NBA.

First, modern authorities define "interest" and "rate" as having compensatory characteristics related to the time-value of money. *See, e.g.*, WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 630 (1989) ("interest" is "a charge for borrowed money[,] generally[14] a percentage of the amount borrowed"); BLACK'S LAW DICTIONARY 730 (5th ed. 1979) ("[t]he percentage of an amount of money which is paid for its use for a

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[14] While "generally" does not mean always, it does reflect the commonly understood or "plain meaning." *See Mazaika v. Bank One, Columbus, N.A.*, 439 Pa. Super. 95, 106-07, 653 A.2d 640, 646 (1994) (*en banc*), *alloc. granted*, 659 A.2d 557 (Pa. 1995); *Copeland v. MBNA America, N.A.*, 820 F. Supp. 537, 540 (D. Colo. 1993). Still, petitioner does not contend that interest must always be stated as a percentage amount. Nor does petitioner insist that penalties can never be a percentage amount. Rather, whether a charge constitutes a penalty or interest depends on whether it bears some relationship to the contractual time-value of money and the amount of the debt. If the charge, as here, bears no such relationship, it is a penalty, not interest.

specified time"). In *Deputy v. DuPont*, 308 U.S. 488 (1940), this Court defined "interest" as "*compensation for the use or forbearance of money*," and stated that "[i]n the absence of clear evidence to the contrary, we assume that Congress has used these words in that sense." *Id.* at 498 (footnote omitted, emphasis added). Here, there is no evidence Congress intended "interest" to mean extra processing charges or penalties imposed in addition to daily finance charges accruing on the entire balance, particularly when there is no forbearance by the lender.

Second, this plain definition of a time-based compensatory charge prevailed when the NBA was enacted. According to the dictionaries of that day, "interest" was a "sum of money paid or allowed for the loan or use of some sum, lent for a certain time, according to a fixed rate." WHARTON'S LAW LEXICON 391 (2d ed. 1860). *See also* 2 ALEXANDER M. BURRILL, A NEW LAW DICTIONARY AND GLOSSARY 629 (1851) (same); JACOB'S LAW DICTIONARY (10th ed. 1797) ("The legal profit or recompense allowed, on loans of money, to be taken from the borrower by the lender"). "Interest" was also defined as "compensation which is paid by the borrower to the lender or by the debtor to the creditor for its use." 1 JOHN BOUVIER, A LAW DICTIONARY 652 (7th ed. 1857). *See also* MARK ORD, LAW OF USURY 29 (3d ed. 1809) ("Interest may be defined to be a certain profit, which the lender is to have for the use of the loan"); PERLEY, PRINCIPLES OF THE LAW OF INTEREST 1 (1893) ("The word *interest* is derived from the latin words, *inter*, between, and *esse*, to be; and has reference to the time between the receiving and the paying back the money for which period only interest is allowed").

Thus, current and historical definitions of "interest" all denote an element of time-based compensation. Sum-certain contingent penalties simply do not satisfy these plain meaning characteristics. As sum-certain charges, late fees are not "compensation" for the time-value of money because they do not vary based on the payment owed or the time period of

delay. They also are not risk-based. Moreover, the fees are imposed in addition to daily accruing percentage interest charges. Although they might reflect a minor element of cost recovery for dunning letters or administrative processing, the late fees are primarily deterrent or punitive charges for a contractual breach. (*See* Pet. App. 114-115). They are, in fact, contract penalties.

On at least three occasions before passage of the NBA, this Court had identified the common law differences between contract penalties, like late fees, and damages in the nature of interest. In *Tayloe v. Sandiford*, the Court stated that "[i]n general, a sum of money, in gross, to be paid for the nonperformance of an agreement is considered as a penalty." 20 U.S. at 17, 7 Wheat. at 8. Later, in *Lloyd v. Scott*, 29 U.S. 205, 4 Pet. 173 (1830), the Court held:

> If a party agree [sic] to pay a specific sum exceeding the lawful interest, provided he do [sic] not pay the principal by a day certain, it is not usury. By a punctual payment of the principal, he may avoid the payment of the sum stated, *which is considered as a penalty.*

Id. at 226, 4 Pet. at 190 (emphasis added). Likewise, just one year before enactment of the NBA, the Court stated with respect to any contingent charge:

> The payment of anything additional depends also upon a contingency, and not upon any happening of a certain event, which of itself would be deemed insufficient to make a loan usurious.

Spain v. Hamilton's Adm'r, 68 U.S. (1 Wall.) 604, 626 (1863).[15]

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[15] In the 1800s, as now, liquidated damages for the costs and expenses incident to a default were regulated not by the statutory rules of "interest" or "usury" but by the contract rules of reasonableness as to penalties. *See, e.g.*, GEORGE SHARSWOOD, POPULAR LECTURES ON COMMERCIAL LAW 30-31 (1856) (agreement to pay costs and expenses incident to default would not be regarded as "interest" or "usury"); *Daly v.*

By commercial and common law standards, therefore, it was clear in 1864 that contingent sum-certain penalties were different from post-default damages measured by an interest rate related to time and the balance owed. "[W]here words are employed in a statute which had at the time a well-known meaning at common law or in the law of this country, they are *presumed* to have been used in that sense unless the context compels to the contrary." *Lorillard v. Pons*, 434 U.S. 575, 583 (1978) (emphasis added, citation omitted). Here, even the context of the language demonstrates that Congress understood "interest" to mean compensation related to the time-value of money.

The term "rate" appears in § 85 at least ten times, and it always refers to a charge that is related to the passage of time. By contrast, § 86 of the NBA provides that, where an excessive rate has been charged, the borrower may recover a penalty equal to twice the interest paid. Unlike the compensatory "rate" language in § 85, the language in § 86 refers to a sum-certain penalty that is totally unrelated to the passage of time. *See First Nat'l Bank v. Morgan*, 132 U.S. 141, 144 (1889) (§ 86 case recognizing a material difference between compensatory "interest" and deterrent or punitive "penalties"). Congress thus knew the difference between compensatory interest "rate" charges based on the passage of time and punitive sum-certain penalties that are unrelated to the time-value of money. Without doubt, the context of § 85 also permits a national bank to charge interest at the highest "rate" allowed to any lender in its home state. *See Tiffany*, 85 U.S. at 411-13. But that context does not limit or even address the

Maitland, 88 Pa. 384, 386 (1879) (Sharswood, C.J.) (contractual agreement to pay commission for collection distinguishable from that of a penalty, which was distinguished yet again from interest); ROBERT B. COMYN, TREATISE ON THE LAW OF USURY 73-74 & n.(a) (R. Pheney, London 1817) (charges for costs are considered "*nomine poenae*" that are "relievable against in equity"). *See also Sun Printing & Publishing Ass'n v. Moore*, 183 U.S. 642, 660-670 (1902) (describing general common law of liquidated damages).

incidental or contractual power of a bank under 12 U.S.C. § 24 to impose late fees or other types of contract terms separate from a compensatory "rate." In short, the plain meaning of "interest at the rate" in § 85 does not reach or preempt the state law penalty claims asserted in this case.

B. The Common Law Definition of "Interest" Excludes Penalty Charges.

Under federal law, it is also a "settled principle of statutory construction that, absent contrary indications, Congress intends to adopt the common law definitions of statutory terms." *United States v. Shabini*, 115 S. Ct. 382, 384 (1994). In fact, there is a strong presumption favoring a common law meaning for words used in a federal statute. This Court recently described that presumption in *United States v. Texas*, 507 U.S. 529 (1993), a case that also dealt with the meaning of "interest" in a federal statute. There, the Court instructed:

> [s]tatutes which invade the common law . . . are to be read with a presumption favoring the retention of long-established and familiar principles. . . . In such cases, Congress does not write upon a clean slate . . . . In order to abrogate a common law principle, the statute must "speak directly" to the question addressed by the common law.

Id. at 534 (citations and internal quotation marks omitted).[16] The Court also distinguished between interest and late fees and found that late fees are "more onerous than the common law" of prejudgment interest. *See id.* at 536 ("Unlike the

[16] Here, the California Supreme Court failed to follow the "long-established" common law meaning of interest identified in *United States v. Texas*. Instead of looking to the common law, it construed "interest" based on the recent legislative definition of Citibank's home state. But the lower court's reliance on South Dakota's special statute was improper. Since § 85 does not " 'speak directly' to the question addressed by the common law," it does not abrogate the common law. 507 U.S. at 534. South Dakota's redefinition of the federal term "interest" also cannot abrogate that common law.

common law, § 3717 also imposes processing fees [for late payments] and penalty charges"). Since late fees are "more onerous than the common law" of interest, they cannot be one and the same as interest.

Cases contrasting usury, the charging of excessive interest, with contingent collection fees further demonstrate this point. *See Merchants' Nat'l Bank v. Sevier*, 14 F. 662, 663, 667 (C.C.E.D. Ark. 1882) (surveying the common law of penalties and the statutory principles of usury). In *Sevier*, an NBA case decided just eighteen years after passage of the Act, a federal circuit court held that a provision in a note imposing collection costs after a loan default was "a stipulation for a penalty or forfeiture [under the common law] . . . and void." *Id.* at 663. The *Sevier* court directly considered the power of national banks to impose post-default collection costs, like attorneys' fees and late fees. Relying on this Court's § 85 decision in *National Bank v. Johnson*, 104 U.S. at 277, the court rejected the argument that a national bank could charge collection costs as "interest." 14 F. at 665.[17] The very fact that courts reviewing bank penalties

[17] The collection fees in *Sevier*, like the late fees here, were post-default costs assessed in amounts unrelated to time or the amount of the unpaid loan. Also, *Sevier* did not depend on a state law definition of "interest," because it was decided under the regime of *Swift v. Tyson*, 41 U.S. (16 Pet.) 1, 18-19 (1841), which established the rule that federal law provides the content of terms implicating general commercial matters. *See* 14 F. at 665-75. *Sevier* further holds that while unfair collection costs could not be charged as "interest" by a bank, reasonable costs could be imposed *within* a bank's home state as a matter of contract law. *See id.* at 667 (Circuit Judge concurring). Since such costs are not interest, each state can limit those costs and thus prohibit both in-state and out-of-state banks from charging excessive contingent fees for a contractual breach. Moreover, while the court below purported to distinguish *Sevier* on the facile ground that the collection costs were labeled attorneys' fees, even attorneys' fees would be "interest" under that court's broad definition of the term. Contrary to the lower court's analysis, the *substance* of the charge, *not the form* should control. Whether labeled a collection fee, a late fee or any attorneys' fee, the issue is whether the charge is measurable by time and

shortly after the NBA recognized the difference between sum-certain default charges and interest, as did the *Sevier* court, demonstrates that § 85 does not abrogate the common law of contract penalties.

Here, as in *Sevier*, the late fees are penalties that may or may not be incurred depending solely on the borrower's conduct. From the start, a late fee is not required for a loan, so a lender has no way of knowing whether or not a late fee will ever be charged. In contrast, a lender committing usury seeks to evade statutory limits on the permissible interest rate by controlling, from the outset, the classification of interest and other charges that will in fact be imposed. Although contingent collection fees imposed because of a contractual breach were *not* regulated as usurious interest, they were limited under the common law of liquidated damages and penalties. *See United States v. Childs*, 266 U.S. at 307; *Sun Printing & Publishing Ass'n v. Moore*, 183 U.S. 642, 660-669 (1902).[18] There is no indication that Congress intended by ambiguity or silence to depart from this longstanding common law when it used the words "interest" and "rate" in § 85.

based on the unpaid balance, so that it is a compensatory rate rather than a punitive forfeiture.

[18] *See also* George W. Field, The Law of Damages §§ 22, 134-56 (1876); Charles T. McCormick, Handbook on the Law of Damages §§ 146-157 (1935); II Samuel Williston, Contracts §§ 769-792 (1920); 5 Samuel Williston, Contracts § 780 (3d ed. 1961); 5 Arthur L. Corbin, Contracts § 1058 (1964); 1 Theodore Sedgwick, Measure of Damages §§ 389-427 (9th ed. 1912); 1 Joseph A. Joyce, Treatise on Damages §§ 1, 2, 33 (1903); 2 *id.* §§ 1333-34; Restatement of Contracts § 339 (1932); U.C.C. § 2-718 (1957). Although certain annotations have attempted to rationalize various state usury laws, they are off-point because they concentrate on post-default "rate" increases, not on sum-certain penalties. *See, e.g.*, Annot. *Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious*, 82 A.L.R. 1213, 1214-23 (1933). Besides, they entirely ignore the distinct common law of penalties. *See United States v. Texas*, 507 U.S. at 534.

Other critical differences between interest and late fees become obvious in the context of delay damages, or prejudgment interest. Delay damages accrue at a particular rate of interest over time and are based on the amount of the debt outstanding. *See United States v. Texas*, 507 U.S. at 536 (describing the common law); *Library of Congress v. Shaw*, 478 U.S. 310, 322 n.7 (1986) (adjustments for the time of payment are made with interest or a delay factor, but not both). The sum-certain late fees here, however, do not depend on an interest rate, the passage of time, or the amount outstanding.

In contrast with "interest," the late fees here are special charges that more than compensate the lender for delay. *See Kothe*, 280 U.S. at 226. In the past, this Court has observed that special charges beyond those for delay were not allowed. In *Loudon v. Taxing Dist.*, 104 U.S. (14 Otto) 771 (1881), for example, the borrower defaulted, requiring the lender to sell his own assets at a substantial discount. After the lender sued for the "costs" of the default, the issue was whether the borrower was liable for more than the time-value of the lender's money. This Court held that interest measured by time was the *only* delay damage allowed:

> *all damages for delay* in the payment of money owing upon contract are provided for in the allowance of interest, which is in the nature of damages for withholding money that is due. The law assumes that interest is the measure of all such damages.

Id. at 774 (emphasis added). *See also New Orleans Ins. Co. v. Piaggio*, 83 U.S. (16 Wall.) 378, 386 (1872) (a party "cannot recover special damages for the detention of money due to him beyond what the law allows as interest"). The ruling below has turned the reasoning of *Loudon* and *Piaggio* upside down and allowed duplicative recovery for a contractual breach. Instead of "interest" based on the unpaid balance and measured by time being "the measure of all such damages," the lower court incorrectly concluded that special, sum-certain penalties also are a measure of delay damages.

The bank's late fees here, like the special charges in *Loudon* and *Piaggio*, do not merely compensate the bank for the contractual time-value of money since they are imposed – in addition to continuing interest charges – primarily to enhance revenues and deter or punish a technical breach. The bank does not condition its loans on the payment of such penalties, nor does it forebear on the contractual defaults that precipitate the charges. Instead of being time-based compensation for the use or forbearance of money, the fees are additional *contingent* charges that do not fluctuate based on any increased risk. Indeed, the basic fees remain static regardless of whether a late payment is $20 or $200 or one day or thirty days late. Thus, the lower court confused the common law distinctions between damages in the nature of interest and special contractual penalties for unliquidated and purported additional processing costs. These common law differences are highlighted by the fact that South Dakota itself deemed it necessary to statutorily redefine "interest" to include such penalty charges in § 54-3-1. Obviously, there would be no need for such a statute if the plain, common law meaning of "interest" had always encompassed these charges.[19]

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[19] Around the time the NBA was passed, most state common law also defined "interest" as the compensation paid by the borrower for the use of the lender's money measured over time. *See Davis v. Rider*, 53 Ill. (53 Freeman) 416, 417 (1870). *See also Kelsey v. Murphy*, 30 Pa. (6 Casey) 340, 341 (1858) ("Interest has been defined to be a compensation allowed to the creditor for delay of payment by the debtor."); *Gaar v. Louisville Banking Co.*, 74 Ken. (11 Bush) 180, 189 (1874) ("Interest is the premium allowed by law for the use of money."). Thus, the components of an interest rate were the amount charged, the amount loaned, and the time involved. Although a few states, such as South Dakota, have recently, by statute, expanded the definition of interest, the basic common law definition has not changed. *See United States v. Texas*, 507 U.S. at 536.

C. The NBA's Legislative History Also Demonstrates That "Interest" Does Not Include Contract Penalties.

As noted, Congress first enacted §§ 85 and 86 in § 30 of the NBA. The predecessor to § 30, section 46 of the National Currency Act, also focused on a time-based *rate* by referring to "interest for delay in the payment of money." 12 Stat. 678-79. Although this phrase was omitted from § 30 a year later, there is no dispute that Congress intended "interest at the rate" to mean compensation "for the delay in the payment of money." In fact, shortly after passage of § 30, this Court held that "[i]nterest is given on money demands *as damages for delay in payment*, being just compensation to the plaintiff for a default on the part of his debtor." *Redfield v. Ystalyfera Iron Co.*, 110 U.S. 174, 176 (1884) (emphasis added). Thus, the time period of delay was always an important feature of "damages in the nature of interest" in the 1800s.

The debates of the 38th Congress likewise confirm that "interest at the rate" in § 85 includes only detention damages that are based on an unpaid balance and measured by time. In deciding whether to set a national ceiling on interest rates, various members of Congress observed that interest rate ceilings varied from state to state. In each and every debate, the members referred to "interest" as a charge measured over time for the use of money. *See, e.g.*, CONG. GLOBE, 38th CONG., 1st SESS. 1353 (1864) (Rep. Cole of California: "In California, the interest is by law, where no rate is expressed in the contract, ten percent per annum"); CONG. GLOBE, 38th CONG., 1st SESS. 1374 (Rep. Kasson of Iowa: "In my own State, sir, we allow a rate of interest of ten percent per annum."); CONG. GLOBE, 38th CONG., 1st SESS. 2122-24 (where several Congressmen recognize the differences in state statutory interest "rate" ceilings). Congress thus considered interest "rate" ceilings (usury laws) to be affirmative legislative actions taken to regulate time-based charges for a loan.

In the legislative compromise that became § 85, Congress undoubtedly considered these interest "rate" ceilings to be

matters of state legislative policy. But Congress did not intend for the states to change the existing common law definitions or principles in order to broaden the preemptive scope of the NBA. *See* CONG. GLOBE., 38th CONG., 1st SESS. 1952-57, 2122-24 (debate over the role of the states). On the contrary, Congress rejected a uniform national interest rate ceiling in order to respect state control and the interests of federalism. *See id.* Besides, the common law of contract penalties, unlike state statutes, applied equally to all businesses and did not discriminate against banks by setting an interest rate ceiling. *See Lloyd v. Scott*, 29 U.S. at 226, 4 Pet. at 190; *United States v. Texas*, 507 U.S. at 536. Because there was no need to alter or even address the common law, Congress borrowed and preempted only the statutory "*interest rate*" ceilings of the states. Hence, § 85, as enacted in 1864, or as subsequently amended,[20] does not plainly state a broader intention to

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[20] In 1974, Congress temporarily amended § 85 and the Federal Deposit Insurance Act to allow national banks and other lenders to charge interest on certain business and agricultural loans at a rate of 5% above the federal discount rate where the bank was located. Act of Oct. 29, 1974, Pub. L. No. 93-501, §§ 201-206, 88 Stat. 1557, 1558-60. In that law, Congress first used the preamble language: "In order to prevent discrimination against . . . banks with respect to interest rates." *Id.* Because the amendment was a temporary law directed at the unique statutory or constitutional usury limits in just three states (Arkansas, Montana and Tennessee), Congress emphasized that it was *not* "overriding [all] state law in this area, *especially with respect to consumer and home mortgage loans*." S. REP. No. 1120, 93d CONG., 2d SESS. 18 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6249, 6261 (emphasis added). As with other common law states, the usury laws of Arkansas, Montana and Tennessee did not apply to contingent charges (late fees) within a borrower's control. *See, e.g., Hayes v. First Nat'l Bank*, 256 Ark. 328, 507 S.W.2d 701, 703 (1974); *Wilson v. Dealy*, 222 Tenn. 196, 201, 434 S.W. 2d 835, 837 (1968). Therefore, the 1974 Congress never intended to and did not preempt the late fee limitations in those states. Nor did Congress intend the preamble language concerning "discrimination . . . against banks" to apply to or preempt evenhanded contract or consumer laws limiting contract penalties, like late fees.

federalize and preempt the distinct common law limiting penalties or forfeitures for a breach of contract.

D. Congress and Federal Regulators Have Repeatedly Defined "Interest" to Exclude Contract Penalties.

In 1933, Congress amended § 85 to permit national banks to charge an alternative federal interest rate of one (1) percent over the discount rate on ninety day commercial paper. *See* 12 U.S.C. § 85. Discount interest (which is collected or charged at the outset of a loan) has never included contingent default charges, like late fees, which may never even arise. (*See* Pet. Br. App. C, reprinting OCC letter describing "discount rate"). In the amendment, the term "discount rate" was added to the same sentence as the phrase "interest at the rate," indicating that the latter should be construed no more broadly than the former. Indeed, this Court has emphasized that important statutory terms should be construed consistently with other terms with which they are associated. *See Gustafson v. Alloyd Co.*, 115 S. Ct. 1061, 1069-70 (1995); *Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961). This rule is particularly apt here, because Congress could not have intended the two alternative rates made available by § 85 to be measured differently so that they could not be compared to one another. After all, if banks were to make an intelligent choice between the discount rate alternative and their home state rate, the two rates would have to include or exclude the same things. Otherwise, the banks could not possibly know which rate was higher. Because discount interest does not include contingent penalties like late fees, loan "interest" must also exclude such charges.

Congress's use of the term "interest" in other laws regulating banks is also instructive. In the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA"), Pub. L. No. 96-221, 94 Stat. 132-193 (1980) (codified in scattered sections of 12 U.S.C.), Congress preempted state laws limiting "interest rates" and "other charges *for* a loan"

but not state laws limiting contract penalties like late fees. In the legislative history accompanying DIDA, Congress explained that "*The Committee does not intend to exempt limitations on prepayment charges, attorney fees, late charges or similar limitations designed to protect borrowers.*" S. Rep. No. 368, 96th Cong., 1st Sess. 19 (1979), *reprinted in* 1980 U.S.C.C.A.N. 236, 255 (emphasis added).[21] Congress therefore again recognized the longstanding differences between penalties and "interest rates" and intended to displace only state interest "rate" ceilings.

DIDA also shows that Congress, as in 1864, was primarily concerned with only the affirmative legislative usury ceilings of the states, not with the common law of contract penalties. For example, DIDA § 521 preempts "State constitution[s] or statute[s]," but makes no mention of the common law. 12 U.S.C. § 1831d. This Court, in *Cipollone*, explained that a federal statute which expressly preempts "any state statute or regulation" may only preempt state legislation and will not generally preempt state common law. 505 U.S. at

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[21] Congress intended this legislative history to apply to every section of DIDA, not just to mortgage loans. When Congress first considered DIDA in 1979, it initially focused only on business and mortgage loans and temporarily enacted as a stop-gap just two sections (sections 501 and 511) of the law. *See* Act of Dec. 28, 1979, Pub. L. No. 96-161, 93 Stat. 1233-35; H.R. Conf. Rep. No. 842, 96th Cong., 2d Sess. 69, 78 (1980), *reprinted in* 1980 U.S.C.C.A.N. 298, 308. Afterwards, in early 1980, Congress revisited those two sections as well as additional sections covering other types of loans. *See* 1980 U.S.C.C.A.N. at 308. At the time, Congress had before it the two Senate Reports, Nos. 96-368 (Oct. 15, 1979) and 96-73 (Apr. 24, 1979) which described the precise preemptive scope of DIDA. Congress therefore had the interpretation of the Senate Reports at its disposal when it reenacted the two temporary sections together with the added sections in 1980 and "did nothing to disapprove of [the] plain meaning reading" of interest as it applied to all sections of DIDA. *Smith v. Fidelity Consumer Discount Co.*, 898 F.2d 907, 913 (3d Cir. 1990).

522-23.[22] The same is true for § 85 because that statute is the model on which § 521 was based. The fact that Congress, in enacting § 521, used language expressly limiting preemption to state statutes or constitutions evidences Congress's belief that § 85 likewise has the same limited preemptive effect. *Cf. In re Asbestos Litigation*, 829 F.2d 1233, 1238 (3d Cir. 1987) (observing that under regime of *Swift v. Tyson*, 41 U.S. (16 Pet.) 1, 18 (1841), the phrase "laws of the several states" was interpreted narrowly to include only statutory enactments), *cert. denied*, 485 U.S. 1029 (1988). Like § 521, § 85 preempts only state legislative ceilings on interest rates. It does not preempt traditional common law and public policy limits on penalties for unliquidated processing costs or to punish a contractual breach.[23]

[22] The Court in *Cipollone* considered the preemptive effect of a federal statute that expressly preempted the "requirements or prohibitions . . . imposed under [s]tate law." The Court compared this statute with an earlier proposed version that had preempted "any state statute or regulation." Finding that the earlier version had preempted only positive enactments of state law, the Court found that the final version preempting "[s]tate law" was not so narrow. 505 U.S. at 523. Thus, the Court implicitly recognized that federal statutes expressly preempting state statutes may not reach state common law.

[23] Unless "interest" is defined as meaning only time-based compensation for a loan of money (and not a sum-certain penalty for a borrower-induced default), other sections of the federal banking laws cannot make sense. For example, under 12 U.S.C. § 347b(a) (1994), "interest" is "a rate equal to the lowest discount rate in effect at such Federal Reserve Bank on the date of such notice." Since a discount rate by definition cannot include a default charge (which may never even arise), interest must also exclude such default charges. Also, pursuant to 12 U.S.C. §§ 371a and 371b, "interest" is the amount that a bank pays on demand deposits and savings deposits. Obviously, a bank cannot pay late fees on savings or demand deposits. *See also* Rev. Rul. 72-315, 1972-1 C.B. 49, 50 ("a 'service charge' is a fixed charge having no relationship to the amount borrowed or the time given to pay whereas interest is based on the amount deferred and the time of deferral"); 12 C.F.R. § 217.2(d) (1995) (Federal Reserve Board defines interest to include "any payment to or for the account of any depositor as compensation for the use of funds" but not expenses incident to a bank's normal function or service charges); 12 C.F.R. §§ 226.4(b)(1) and (c)(2) (Federal Reserve Board defines "late charge" as entirely different from the broad term "finance charge," which includes interest, in the Truth-in-Lending Act); 1980 U.S.C.C.A.N. at 255 (equating loan interest in DIDA with deposit interest).

E. Single-Sum Late Fees Do Not Embody the Essential Characteristics of Interest.

Despite the overwhelming body of law establishing that single-sum late fees and other contract penalties are not interest, some courts construing § 85, including the court below, have erroneously held otherwise. These courts, glossing over the bulk of the controlling precedent, have jumped on the bandwagon propelled by the wrongly decided case of *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 506 U.S. 1052 (1993). The *Greenwood* court concluded that DIDA § 521 preempts a Massachusetts consumer protection law prohibiting credit card late fees.[24] In so holding, the court misread a number of the authorities on which it relied and failed to recognize the undeniable differences between contingent penalties for a contractual breach and interest as damages for delay.

For example, as support for the conclusion that single-sum late fees may be interest, both the court below and the *Greenwood* court cited the non-§ 85 and non-NBA cases of *Shoemaker v. United States*, 147 U.S. 282 (1893), and *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177 (1873). Both of those cases are off-point, however, because they involve delay damages

[24] The court in *Greenwood* completely disregarded the strong presumption against preemption recognized in *Maryland v. Louisiana*, 451 U.S. 725, 746 (1981), and many other cases. The *Greenwood* court recognized that the term "interest" was "susceptible to interpretation – not that the Commonwealth's interpretation . . . [was] necessarily wrong or that the appellant's interpretation [was] necessarily correct." 971 F.2d at 828. The court also found that DIDA's text and legislative history were "inconclusive." *Id.* Yet, despite the ambiguity, the *Greenwood* court found preemption.

(*i.e.*, prejudgment interest charges measured by time and the balance owed to compensate for delay), not penalties for a contractual default. In *Shoemaker*, this Court recognized that interest "accrues." 147 U.S. at 321. Similarly, in *Brown*, the Court held that time-based damages did not accumulate ("run") during the Civil War when the obligation to repay the principal of a loan was suspended. 82 U.S. at 185-86.

The single-sum late fees here, in contrast, cannot "run" or "accrue" and are not measured by time. In fact, this Court's more recent decision in *United States v. Texas*, 507 U.S. at 536, explains the relevant principles of delay damages (prejudgment interest) that were only touched upon briefly in *Shoemaker* and *Brown*. Given that *United States v. Texas* holds that late fees are not part of the common law of prejudgment interest, *Shoemaker* and *Brown* cannot stand for the erroneous proposition that penalty charges are interest.

Both the *Greenwood* court and the lower court further assumed that any lender imposed fee could constitute interest. But the cases cited by the court do not stand for that boundless principle. As the New Jersey Supreme Court observed in *Sherman*, 143 N.J. at ___, 668 A.2d at 1044-46, the authorities relied upon by *Greenwood* simply do not indicate that single-sum late fees are interest.[25]

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[25] Under the Federal Reserve Board's definitions for the Truth-in-Lending Act, 15 U.S.C. § 1601 (1994), it is readily apparent that the cases cited in *Greenwood* are entirely different from the present case. The charge in *American Timber and Trading Co. v. First Nat'l Bank*, 690 F.2d 781, 787-88 (9th Cir. 1982), involving compensating balance requirements, would constitute a "finance charge" under 12 C.F.R. § 226.4(b)(5) (1995). The cash advance fee in *Fisher v. First Nat'l Bank*, 548 F.2d 255, 258-61 (8th Cir. 1977), would constitute a transaction "finance charge" under 12 C.F.R. § 226.4(b)(2). The bonus or commission in *Cronkleton v. Hall*, 66 F.2d 384, 387 (8th Cir.), *cert. denied*, 290 U.S. 685 (1933), would be a finder's fee "finance charge" within the meaning of 12 C.F.R. § 226.4(b)(3). As noted, a late fee is not a "finance charge," because it is not "interest" compensation for the use of money. *See* 12 C.F.R. § 226.4(c).

Until *Greenwood* and its progeny, the plain meaning of "interest" was a compensatory rate based on the amount of the unpaid loan, measurable over time or required up-front as consideration for the loan. Despite the more than 150 years of case law recognizing these characteristics, *Greenwood* and the decision below do not even mention them. Nor do they address the substantial body of liquidated damages law that would not exist but for the differences between single-sum late fees and interest.

F. "Interest" In § 85 Must Be Interpreted Narrowly.

This Court has long held that because a violation of § 85 subjects a national bank to the § 86 penalty of forfeiture of double the interest collected, the statute must "receive a strict, that is literal construction." *Tiffany*, 85 U.S. at 410. Indeed, a national bank "is not to be subjected to a penalty unless the words of the statute plainly impose it." *Id.*; *see Keppel v. Tiffen Sav. Bank*, 197 U.S. 356, 362 (1905). Thus, to avoid subjecting the fledgling national banks to the severe penalty for usury, Congress must have intended "interest at the rate" to be construed narrowly. Otherwise, the banks would be exposed to usury claims any time a separate fee caused the interest rate to exceed the statutory ceiling. Congress did not intend that result. Congress instead intended a plain federal meaning for "interest at the rate" that does not include the sum-certain late fees exported by Citibank into California in this case.

G. As A Matter Of Public Policy, "Interest" In § 85 Does Not Preempt State Laws Limiting Contract Penalties

At the petition stage, Citibank professed reliance on informal federal regulatory opinions and projected imminent doom should this Court uphold the presumption against preemption in this case. Those proclamations, however, have been directed to the wrong forum and are beyond the record in this case. It is Congress's role, not the Court's or the

regulators', to rewrite legislation to address the bank's policy concerns. *See Gregory*, 501 U.S. at 460. As this Court has stated, "any plea to alter § 85 . . . is better addressed to the wisdom of Congress." *Marquette*, 439 U.S. at 319. Moreover, the bank's reliance arguments are misplaced. The federal law applicable to a particular case does not turn on whether litigants actually relied on an administrative rule. *Harper v. Virginia Dep't of Taxation*, 113 S. Ct. 2510, 2516 n.9 (1993).

Citibank further insisted below that prohibiting single-sum late fees will require credit card issuers to raise periodic percentage interest rates, which will purportedly restrict the availability of credit to high risk borrowers. Those unsupported contentions miss the point, however. The importance of our federalist system lies in the ability of each state to make its own policy decisions for its own citizens in the absence of clear Congressional intent to the contrary. Here, California has balanced consumer rights and business interests differently than has South Dakota. Congress has not itself directly addressed the subject. Besides, since this case was dismissed at the pleadings stage, there is absolutely no credible economic evidence in the record to support the assertion that permitting late fees increases the number of consumers who can qualify for a credit card. If, however, the Court looks beyond the record, it should focus on the fact that Citibank has obtained an unfair economic advantage over the many other out-of-state card issuers who have complied with the California law limiting late fees and other penalties.

In sum, the *in terrorem* pleas and economic reliance arguments of the bank disregard the legitimate legislative choices made by California. That state limits contractual penalties as a matter of public policy to prevent further oppression of a party with unequal bargaining power who may already be at an economic disadvantage and may lack any alternative but to pay the penalty. California's public policy decision is the prerogative of the California legislature. While Citibank may disagree with that public policy decision, it cannot point to any contrary decision by Congress. Citibank's

plea that this Court judicially amend § 85 to create an *ad hoc* federal policy is misdirected. "For if in close or uncertain cases a court proceeds to preempt state laws where that result was not clearly the product of Congress' considered judgment, the court has eroded the dual system of government that ensures our liberties, representation, diversity, and effective governance." THE LAW OF PREEMPTION, *supra* p. 2, note 1, at 47.

CONCLUSION

For the foregoing reasons, the judgment of the California Supreme Court should be reversed.

Dated: March 1, 1996

Respectfully submitted,

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APPENDIX A

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article I, section 1 of the United States Constitution directs, in pertinent part, that "[a]ll legislative Powers herein granted shall be vested in a Congress of the United States." U.S. Const. art. I, § 1.

The Supremacy Clause provides:

> This Constitution, and the laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. Const. art. VI, cl. 2.

The Full Faith and Credit Clause requires, in pertinent part, that "Full Faith and Credit shall be given in each State to the public Acts, Records, and Judicial Proceedings of every other State." U.S. Const. art. IV, § 1.

Section 30 of the National Bank Act, as codified at 12 U.S.C. § 85, provides, in pertinent part:

> Any [national bank] may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest at the rate allowed by the laws of the State . . . where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located,

whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under state laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter. . . .

12 U.S.C. § 85 (1994).

Prior to codification, Section 30 of the National Bank Act also provided what is now codified, in pertinent part, in 12 U.S.C. § 86:

> The taking, receiving, reserving, or charging a rate of interest greater than is allowed by section 85 of the title, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid, the person by whom it has been paid . . . may recover back, in an action in the nature of an action on debt, twice the amount of the interest thus paid. . . .

12 U.S.C. § 86 (1994).

The California Civil Code section 1671 states, in pertinent part:

> (b) Except as provided in subdivision (c), a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made.

> (c) The validity of a liquidated damages provision shall be determined under subdivision (d) and not under subdivision (b) where the liquidated damages are sought to be recovered from either:
>
> (1) A party to a contract for the retail purchase, or rental, by such party of personal property or services, primarily for the party's personal, family, or household purposes; or
>
> (2) A party to a lease of real property for use as a dwelling by the party or those dependent upon the party for support.
>
> (d) In the cases described in subdivision (c), a provision in a contract liquidating damages for the breach of the contract is void except that the parties to such a contract may agree therein upon an amount which shall be presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.

Cal. Civ. Code § 1671 (West 1985)

Section 54-3-1 of the South Dakota Codified Laws states as follows:

> Interest is the compensation allowed by law for the use, or forbearance, or detention of money or its equivalent, including without limitation, points, loan origination fees, credit service or carrying charges, charges for unanticipated late payments, and any other charges, direct or indirect, as an incident to or as a condition of the extension of credit. These charges do not include charges made by a third party.

S.D. Codified Laws Ann. § 54-3-1 (1990).

Section 54-3-1.1 of the South Dakota Codified Laws states, in relevant part, that:

> Unless a maximum interest rate or charge is specifically established elsewhere in the code, there is no maximum interest rate or charge, or usury rate restriction between or among persons, corporations, estates, fiduciaries, associations, or any other entities if they establish the interest rate or charge by written agreement

S.D. Codified Laws Ann. § 54-3-1.1 (1990).

APPENDIX B

JUN 25 1964

In your letter of May 22, 1964, you made three inquiries.

First, you ask the maximum interest rate that a National Bank may charge in certain specified states. Subject to certain exceptions it may generally be stated that National Banks in California, Illinois, Wisconsin and Kansas may charge interest at a rate up to ten per centum per annum, while in Illinois the normal maximum rate is seven per centum per annum.

Secondly, you inquired as to what charges paid by consumers for consumer credit obtained from a National Bank with respect to auto financing are not considered to be interest. Charges for late payments, credit life insurance, recording fees, documentary stamp are illustrations of charges which are made by some banks which would not properly be characterized as interest.

Thirdly, you requested information as to the formula used by bank examiner to convert charges to rate equivalent for purpose of determining whether the charges are at an excessive rate. Because of the inter-relation of state laws with Federal laws there is no set formula. The examiner must look at each question transaction with the view of uncovering any unlawful practice on the part of the lending institution. In questionable cases the problem is referred to the Law Department of the Office of the Comptroller of the Currency for review.

If you should desire any additional information this Office would be please [sic] to furnish such information upon request.

Sincerely,

(Signed) James J. Saxon
James J. Saxon
Comptroller of the Currency

APPENDIX C

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219
Jul 01, 1980

Dear Mr. ______________

This is in response to your letter of April 14, 1980, in which you ask for an interpretation of 12 U.S.C. § 85, in light of the 3% surcharge which the Federal Reserve Banks have recently imposed on loans to certain institutions.

Section 85 allows national banks to charge interest on loans "at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located. . . . " Unlike § 511(a) of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA"), Pub. L. No. 96-221, which allows national banks to charge on certain loans "5 per centum in excess of the discount rate, *including any surcharge thereon*" (emphasis added), § 85 makes no mention of the surcharge. Instead, it looks only to the discount rate itself. Furthermore, §§ 521, 522, 523, and 524 of DIDA, which extend the Federal Reserve discount rate option to other financial institutions, similarly make no mention of the surcharge. Thus, interpreting 12 U.S.C. § 85's discount rate as including the surcharge would make the above-quoted language in § 511(a) of DIDA unnecessary.

It is therefore my opinion that "discount rate," as employed in 12 U.S.C. § 85, refers only to the base discount rate, and not to any surcharge imposed by the Federal Reserve Banks, whether or not a particular bank is paying that surcharge. It should, however, be noted that this conclusion is also based upon the nature of the recently imposed surcharge, *i.e.*, the fact that it was not imposed upon all member banks. My conclusion may differ if, at some future time, the Federal Reserve Banks impose a "surcharge" on loans to all member banks.

I trust that this has been responsive to your inquiry.

Very truly yours,

John E. Shockey
Chief Counsel